Rating-Agentur Expert RA confirmed at 'BBB-' the ratings of Cyprus. The rating outlook is stable. The rating was withdrawn.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Cyprus at 'BBB-' (Moderately high level of creditworthiness of the government) in national currency and at 'BBB-' (Moderately high level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Public debt management continues to be supportive and debt remains well-structured. Only 1% of obligations is short-term and 4,6% is scheduled to be paid within 2019. Moreover, 97% is denominated in local currency and 61% has fixed interest rate. Also, most of the debt with free floating interest rate is provided by the European Stability Mechanism on concessional terms;
- Overall fiscal surplus to GDP in 2018 was 0,9 p.p. higher than a year before and reached a level of 2,7% mainly driven by larger revenues from indirect taxes. We expect the fiscal balance to remain positive in medium term. However, the introduction of National Health Scheme in 2020 might significantly elevate government expenditure;
- The macro environment of Cyprus is progressing. Real GDP continued to grow by 4,2% and GDP per capita at PPP remained strong at USD 39 100 in 2018. In 2019, we expect the Cypriot economy to grow at a pace similar to that of 2018;
- In the ease of Doing Business ranking Cyprus took the 57th place out of 190 countries (down from 53rd primarily due to complications with getting construction permits) showing comfortable levels of institutional development. Additionally, it has a very high Human Development Index (adjusted for inequality) at 0,768 according to the latest edition;
- Cyprus is ranked 74th out of 214 territories in the Rule of Law Index, according to the World Bank's Worldwide Governance Indicators (improvement of one place as compared to the previous report) which demonstrates strong confidence in contract enforcement, property rights, the police and the courts;
- After the rapid growth of FDI supported by a boost in the construction and real estate sector in 2017, this indicator came back to its regular levels with net inflows of FDI to GDP around 6% in 2018 (48% in 2017). We expect further gradual growth of FDI in coming years encouraged by a range of government incentives (such as the Cypriot Investment Scheme).

Restricting factors:

- Overall credit growth continued to decline in 2018. The banks' asset to GDP ratio dropped down to 294% that is 16,1% decrease y-o-y and total loans provided to domestic residents went down by 23,8% in absolute terms. Mainly, this could be explained by debt write-offs and loans transferred from several banks to credit acquiring companies, as pure new loans to households only increased slightly by 0,6% y-o-y in 3Q 2018. Nevertheless, credit to economy remains the highest among Cyprus' peers[1];

- Cyprus' unemployment at the end of 2018 was 8,5% - down from 11,1% the previous year. It is the lowest rate recorded since 2013. Moreover, the youth unemployment ratio also decreased by 4,1p.p. down to 20,6% in 4Q 2018 and we expect the number to continue to decline in 2019. On the other hand, the average part time employment for the year remained high at around 12%. Also 8% of total employment is related to construction sector which might be a temporary activity;

- Despite the currently limited effect of the public banking sector on budget sustainability, contingent liability risk remains. Government guarantees slightly decreased by 0,3p.p. to 8,8% of GDP in 2017, but still pose a risk for public finances;

- The Harmonized Index of Consumer Prices (HICP) increased to 2,4% in 2018 mainly pushed by rising food, housing and energy prices, but remained below the average in the Euro area;

- Economic activity continues to be concentrated in tourism and wholesale. At the end of 2018, more than 23% of total GDP was related to retail, accommodation and food services and 10% was linked to real estate activities;

- Cyprus ranked 44th out of 140 countries in the Global Competitiveness Index report, one place lower than in 2017. The main factors constraining the score are limited market size and financial system stability. In addition, the trade balance remained negative at around -1,5% of GDP for 2018;

- Despite government intentions to continue with the privatization program, it remained delayed, postponing real structural reforms and sustainable development. We expect that the Ministry of Finance will resume implementation of privatization plans in the future, as there are ongoing discussions on the corresponding legal framework.

Negative factors:

- Gross government debt increased by 11% in absolute terms by end-2018 reaching more than 106% of GDP and 270% of budget revenues. Such hike is associated with Cyprus Cooperative Bank (CCB) liquidation which included a government provision of around EUR 3,5 bn in form of a bond placed to support the balance sheet of the bank. In 2019, we expect metrics to move backwards into a decreasing trend taking into consideration solid economy growth and robust fiscal performance;

- Cyprus`s banking sector recovery is still constrained by low asset quality illustrated by substantially high NPL to total loans ratio of around 33% at the end of 2018. Despite a significant improvement of the indicator, from 40% a year earlier, primarily driven by around EUR 6 bn of CCB's NPL reclassification, further restructuring measures would be challenging as most of the loans already were restructured at least once. Further decreasing the volume of NPLs would rather depend on the development of payment discipline. At the same time, the capitalization level remains substantial and profitability of banks improved with a positive value of ROA at 0,7% as of 3Q 2018 as compared to -1,2% for the same period in 2017;

- The stock market remains underdeveloped with only 67 listed companies as of January 2019 (two companies were suspended from the trading in 2018 for not providing information on financial results), and market capitalization dropped down to EUR 1,93 bn in January 2019 (9,7% of GDP) from EUR 2,35 bn for respective period in 2018.

Support factors:

- Participation in a strong currency and political union. Cyprus is part of the European Economic and Monetary Union (EMU) since 2004 (moderately strong support factor);

[1]Cyprus peers include the "peripheral Eurozone" countries such as Portugal, Italy, Spain and Greece.

- The country has a very strong and important reserve currency (EUR) (moderately weak support factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued diversification of the economy and improvements of macroeconomic performance;
- Further reduction of the NPL to total loans ratio alongside an overall deleverage of the economy.

The following developments could lead to a downgrade:

- Deterioration of the banking system's asset quality.

"The Agency confirmed the ratings of Cyprus at 'BBB-' based on solid economic growth, together with significantly lower share of distressed loans in the banking system and further progress in the fiscal position. Moreover, the unemployment reached its lowest level in five years and continues to constantly decline. Investment attractiveness improved, with positive net FDI flow due to the boost in construction sector. Despite high fiscal costs of the government's intervention in Cyprus Cooperative Bank (CCB), we believe that public debt is well structured and will turn back to a declining path.

However, banks' weak asset quality together with insufficient diversification of the economy are the main downside factors for the creditworthiness of the sovereign." - Clarified Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA.

Research report on Cyprus is available at:

https://raexpert.eu/reports/Research_report_Cyprus_05.04.2019.pdf

Next scheduled rating publication: The rating was withdrawn. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

For further information contact:

Responsible expert:
Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 1216
E-mail: kolokolova@raexpert.eu

Reviewer:
Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 1211
E-mail: gorchakov@raexpert.eu

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
05.10.2018	Scheduled review of both types of ratings for the country	BBB-	BBB-	Stable	Stable
06.04.2018	Scheduled review of both types of ratings for the country	BB+	BB+	NA	NA
06.10.2017	Scheduled review of both types of ratings for the country	BB+	BB+	NA	NA
07.04.2017	Scheduled review of both types of ratings for the country	BB	BB	NA	NA
14.10.2016	Scheduled review of both types of ratings for the country	BB	BB	NA	NA
22.04.2016	First assignment of both types of ratings for the country	BB-	BB-	NA	NA

Minute's summary

The rating committee for Cyprus was held on 4 April 2019. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from May 2018). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, Central Bank of Cyprus, European Central Bank, Ministry of Finance of Cyprus, Cyprus Stock Exchange (CSE), German Stock Exchange.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.